

Helsingin yliopisto - Helsingfors universitet - University of Helsinki ID 2002-1897

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| Työn nimi-Arbetets titel-Title Competition in banking and economic growth | | | |
| Oppiaine-Läroämne-Subject Economics | | | |
| Työn laji-Arbetets art-Level Licentiate thesis | | Aika-Datum-Month and year 2002-11-19 | Sivumäärä-Sidantal-Number of pages 68 |
| <p>Tiivistelmä-Referat-Abstract</p> <p>Our study examines implications of banking sector competition on economic development in an endogenous growth model, where the role of business creation is emphasised as a driving force. Production of information on potential investment projects by exerting screening is identified as a key function of viable banking sector.</p> <p>Assuming perfect screening technology, we derive the anticipated result that intensity of screening is adversely affected by increasing competition in banking sector. As a novelty, we also discuss a case where the assumption of perfect screening is relaxed, and introduce an option to liquidate unprofitable projects in an interim stage of financing relationship. It will be shown that screening activity may actually rise along with intensified competition, because banks start to substitute imperfect screening for liquidation as selection mechanism.</p> <p>Regarding the linkage to real sector, monopolistic competition tends to cause inefficiencies dampening the fraction of 'productive finance' in financial intermediation, which results from monopoly banks' tendency to lend 'too little with too high price', and possibly from excessive investment in entrepreneurial selection. Under plausible assumptions, liquidation option will amplify the distortions caused by market power. Increasing competition in banking in turn may hurt Financial efficiency by inducing too 'slack' screening, which unambiguously impairs the average quality of financing projects in the economy. In addition, since intensifying competition narrows the intermediation margin, the fixed start-up costs become harder to bear causing 'over-investment' in single projects with diminishing returns.</p> <p>Consequently, the relationship between banking sector competition and growth is likely to be non-monotonic. Under plausible assumptions, we derive an 'inverted U-shape' as a general pattern to describe competition-growth relationship, implying that a growth-maximizing market structure would be an oligopoly.</p> | | | |
| Avainsanat-Nyckelord-Keywords banking financial intermediation competition endogenous growth screening option to liquidate | | | |
| Säilytyspaikka-Förvaringsställe-Where deposited | | | |
| Muita tietoja-Övriga uppgifter-Additional information | | | |